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Economic Conditions
Governmental Finance
United States Securities

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General Business Conditions

THE month of April has provided more than a normal quota of important economic developments, and except for the crisis in the coal fields they have been mainly of a favorable nature. The first interest of the country is in the military news, and the progress of the armies in Tunisia has created general satisfaction and confidence. Also, the demonstration of air superiority over both the Mediterranean and Germany, combined with Mr. Nelson's announcement that this country would produce 7,000 planes in April, holds high promise for the struggles to come.

At home the goal of the Second War Loan has been surpassed by a substantial margin. The President has issued a "hold-the-line" order to tighten price and wage controls, and the prospect for legislation to place income taxes on a "pay-as-you-earn" basis has brightened again under pressure of public clamor, after the collapse of previous proposals in the Congressional deadlock at the end of March. These are moves which should have general support. Evidence of the tremendous buying power in people's hands has appeared once more in the heavy Easter trade, following the boom in retail sales only a few weeks earlier. This buying is cutting into supplies of consumers' goods faster than they can be replenished, and it again directs attention to the need of measures to divert more of the national income back into the Treasury, to combat the inflation menace.

In the war industries production is still on the rise; curtailment in output of tanks, military vehicles and certain ordnance items, in which contracts have been cancelled or slowed down, thus far has meant chiefly that labor and materials have been shifted to speed the production of ships, planes and other things that are now more needed. Working hours are reported lower in some instances, but these are the exceptions. The Federal Reserve Board's index of industrial production gives evidence that no overall slackening has taken place, for in March it reached a new peak at 203 (1935-39=100). Although cancellation of ordnance contracts became a subject of comment six months ago, this index has climbed twelve points in that period. Further increases in supplies of steel, aluminum, magnesium and some other materials will support additional gains in coming months.

It is increasingly probable, however, that industrial production in the aggregate is approaching its ceiling. Not only are limitations of materials and manpower slowing down the three-year rise, which has doubled output since the Spring of 1940, but shifts in the requirements of the war program make it difficult to get the utmost out of available facilities. The decline in construction contract awards is the forerunner of reduced construction employment, which in some sections has already appeared. Machine tool backlogs are falling off considerably and even shipments are declining somewhat. In short, the stage of preparation, construction and equipment for the war effort is nearing its close, while simultaneously the production stage is so well advanced in some directions that the policy is to cut back. These are offsets to the expansion elsewhere.

The Coal Crisis

The spreading stoppages in coal mining and the threat of a general coal strike represent the gravest danger to industrial production, and thus to the war effort, which has appeared since the war began. President Roosevelt has demanded that the miners continue at work, and declared that he will use all his powers to get coal mined. Mr. Lewis's reply is that the wage demands should be handled through collective bargaining, as they would be in peacetime, without reference to the War Labor Board. This Letter goes to press before the outcome can be predicted.

It seems inconceivable that the needs of the war, the force of public opinion, the authority of the Government, and the no-strike pledge of labor can all be ignored by the miners, to the point of halting coal production. The words of

President Woodrow Wilson, delivered October 25, 1919, on the occasion of another threatened general bituminous coal strike, should be read again — and be it noted that the country was then at peace:

> A strike under these circumstances is not only unjustifiable, it is unlawful . . . I cannot believe that any right of any American worker needs for its protection the taking of this extraordinary step, and I am convinced that when the time and manner are considered, it constitutes a fundamental attack, which is wrong both morally and legally, upon the rights of society and upon the welfare of our country. I feel convinced that individual members of the United Mine Workers would not vote, upon full consideration, in favor of such a strike under these conditions.

In his annual message to Congress December 2, 1919, President Wilson declared:

> There is a predominant right, and that is the right of the government to protect all of its people and to assert its power and majesty against the challenge of any class.

The "Hold-the-Line" Order

Two major questions are involved in this crisis. The first, which probably will be quickly settled, concerns the right of any population group to refuse to abide by the procedures set up for wartime wage adjustment, even to the point of imperilling war production. The second concerns the effect of the ultimate settlement of the miners' demands upon the general price and wage stabilization program. President Roosevelt moved early in the month to prevent another acceleration of the inflationary spiral. On April 2, in a strong message, he vetoed the Bankhead bill, which would raise the minimum levels at which ceilings are permitted on certain farm products. On April 8 he issued the "hold-the line" order, which directed the appropriate authorities to fix price ceilings on all unceilinged commodities affecting the cost of living; to halt increases in wages and salaries except where allowable under the Little Steel formula or to correct substandards of living; and to prevent workers in essential industries from shifting employment to obtain higher pay. The coal miners are not entitled to a wage increase under the Little Steel formula.

Since the President's order was issued, demands for new political action to raise farm prices have been in abeyance. But if any substantial wage increase should be granted to the miners, wage demands almost certainly will be pressed in the industries generally, and there is great danger that the Bankhead bill and other farm bloc proposals will be revived. This would set a new revolution of the inflationary spiral under way.

On the other hand, if the mine workers' case is handled in a way which preserves the stabilization formulas and the wage control machinery and procedures, and does not give great concessions to which other groups can point, a considerable abatement of new wage demands, and of political moves to raise farm prices, is to be expected. The "hold-the-line" order will have a real chance to work.

There are many influences pushing upward on prices and wages, including the inflationary pressure generated by the government deficit and the resulting bank credit expansion; the surplus of consumer buying power over consumer goods production; the inequalities and dislocations which result from rigid controls, with disturbing effects upon production and distribution; and the difficulties of enforcing controls when they are set up. However, the "continued pressure for increased wages and increased prices," mentioned in the President's "hold-the-line" statement, plainly referred to the pressure exerted through political channels, and upon government agencies, by interested groups.

At no previous time has the opportunity to relieve the situation of this particular pressure, which menaces the stabilization program, been so clear-cut, or the need to suppress it more urgent.

Operation of Price Controls

The country has now enough experience with price controls to know that to operate them with any success requires the highest possible degree of both practical understanding and economic statesmanship. The principal lesson learned has been that exceptions to the general orders endanger the whole structure, for the reason that one man's prices are another's costs. Another is that formulas must be simple, fair and workable. A third is that trade practices should be followed, and co-operation enlisted and maintained. A fourth is that adequate machinery for enforcement must be created. A fifth is that direct controls should be supplemented and supported by fiscal measures, to absorb surplus income.

To create and operate such systems of control, and in such a manner as to preserve inducements to production and distribution, challenges the capacities of the ablest and most experienced men in this country. The correction of situations where production is depressed, and distribution disturbed, itself may throw other price relations out of line, and therefore endanger stabilization. Perhaps a perfect or near-perfect performance of the task is impossible. In normal times it would be judged so, and people would be likely to refuse their co-operation and obedience if it were attempted. But in wartime, with the inflationary danger crowding in, the effort must be made.

Proposal for Ceilings on Cotton

The withdrawal of the hasty proposal to place price ceilings on raw cotton is evidence of a growth of experience and a practical view

of price control problems. The proposal was based on the President's order to bring all cost of living commodities under ceilings, but it overlooked the fact that the cost of living is not affected by raw cotton, but only by manufactured cotton products, upon which ceilings have long been established. Only as advances in raw cotton threatened to force goods ceilings higher could cotton ceilings be justified.

However, this was not the principal consideration. The basic reason why ceilings on cotton are unnecessary is that there is no shortage except as the Government itself has artificially created one by withholding cotton from the market. The Commodity Credit Corporation, a government agency, owns outright some 2,750,000 bales, holds under loans which are past due an additional 700,000 bales, and has approximately another 2,750,000 bales of 1942 cotton under loans which mature July 31, but which can be called at any time. With this cotton under its control the Government obviously can prevent a runaway market by offering its holdings for sale. Ceilings, on the other hand, would be immensely complex because of the numerous grades and staples and the differences between markets. These differences fluctuate, and the fluctuations serve the purpose of adapting the character of the demand to the character of the supply. Fixed ceilings would leave the markets without this necessary flexibility. Also, the system of hedging under which the crop is marketed, and which permits it to be carried and distributed at low costs and low profit margins, would inevitably be disrupted.

It is to the credit of the authorities and particularly of Mr. Chester C. Davis, the War Food Administrator, that the decision has been made to offer government-owned cotton to the limit permitted by law, which is 300,000 bales in any month. In addition the "free supply" may be augmented by farmers repossessing their cotton from the loan and selling it on the market, which may appear more attractive to them if they understand that the Government is determined to keep the price down; and the Commodity Credit Corporation may call loans to force on to the market, if necessary, the higher grades which are especially in demand. It is believed also that specifications on certain Army and Navy goods could be modified without material sacrifice of quality, in order to reduce requirements for the higher grades.

Mr. Davis's decision was reached in consultation and co-operation with members of the cotton trade, and it is practical and simple as contrasted with other measures which have rejected trade experience. Unfortunately the opportunity of combating rising prices by throwing additional stocks on the market exists in only a few commodities; but the example of a practical approach to the problem, and of dealing fairly and freely with the trade, is to be commended.

Success of the Second War Loan

The minimum quota set by the Treasury for the Second War Loan was $13 billions, and on the basis of figures so far available, expectation that total sales will be upward of $16 billions appears well justified. Apart from reaching the quota, two objectives were sought in the loan. One was to obtain more widespread subscriptions from individuals, particularly those whose incomes have had large increases during the war, in order to divert this money into the Treasury and relieve the consumers' goods markets of inflationary pressure. The second objective was to place a larger proportion of the securities outside of the principal money centers of New York and Chicago, since banking reserves are relatively low in these cities.

Until final reports are available, conclusions as to the success in reaching these objectives can be only tentative. However, partial figures supply some indications. Commercial bank allotments of the 2 per cent bonds of 1952-50 and the ⅞ per cent certificates of indebtedness were limited to $2 billions or thereabouts of each issue (both were many times oversubscribed); and counting new money raised through increased sales of Treasury discount bills, the part of the loan taken by commercial banks has approximated $5 billions. On this showing practically 70 per cent of the loan came from non-banking sources, compared with 59 per cent in the December Victory Loan.

This comparison is favorable, but more detailed figures will be necessary to determine the respective shares, in the "non-banking" classification, of individuals on the one hand and corporations, savings institutions, trust funds, etc. on the other. Early reports indicated that subscriptions from individuals were disappointing, while those from savings institutions particularly were exceeding expectations. Before the drive it was the general opinion that insurance companies and savings banks would not have funds in April to equal their December purchases, but this view has proved mistaken. Probably they had sold other securities to build up their cash to a greater extent than was generally appreciated; in any event, their subscription passed their December totals well before the loan was closed. Subscriptions by corporations likewise exceeded quotas, in most Federal Reserve districts, early in the drive. Undoubtedly the number of individuals who subscribed to the loan has been far greater than in December, but as the bulk of the increase in number was in the series E war savings bonds, the average purchase was relatively low.

New York's Participation

Preliminary figures also suggest that districts outside New York have absorbed a slightly larger percentage of the loan than in December. This does not signify poor sales in New York; on the contrary, this was the first district to exceed its non-banking quota, which it did at the half way point in the drive. Rather, the figures mean that the relative distribution of the securities outside the money centers has been, to some extent at least, improved. Of the total allotment to commercial banks of the new Treasury certificates of indebtedness, banks in the New York district took 31 per cent. This compares with 36 per cent of allotments of the similar certificates in the December loan. In overall subscriptions, the New York district's proportion seems likely to be little if any above 40 per cent, compared with 48 per cent in December.

The good results of the loan are attributable not only to the patriotic response of the people and of business institutions to the national need, but to the development of a greatly expanded and more effective sales organization, and to longer and more thorough preparation than was possible in the December drive. In its employment of publicity, street rallies and other special events, the campaign has resembled the Liberty Loan drives of the last war. Hundreds of thousands of volunteer workers participated. Future loan drives will gain in effectiveness from the experience developed and the organization built up now.

There is no reason for complacency, however, in the fact the Treasury has raised in three weeks a sum far greater than ever realized in a like campaign anywhere. The real success of Treasury loans is measured not only by the amounts raised but also according to where the money comes from. If the loans draw too generally upon funds which were destined to be saved in any case, the inflation pressures are not materially reduced. The true goal is to reach money which otherwise would be spent.

Effects on the Money Markets

The loan has caused no strain in the money markets; on the contrary, excess reserves of the banking system have increased. In December bank reserves had to be augmented by heavy Federal Reserve Bank purchases of securities, but the enactment on April 13 of the Wagner-Steagall Act, which removed the requirement that cash reserves be held against government deposits, has changed the situation. As individuals and corporations subscribed to the new loan their deposits, against which reserve is required, were shifted into government deposits. Reserve requirements were lowered correspondingly and excess reserves increased. The deposits credited to the Government by the banks in payment for their own subscriptions to the loan are likewise now free of reserves. Thus government loans under the new law ease the money market temporarily, instead of tightening it. The Wagner-Steagall Act also removed the Federal deposit insurance assessment upon government deposits.

After the loan is closed the trend of excess reserves in due course will be reversed. Government deposits in the commercial banks will be called by the Treasury and paid out again to corporations and individuals, returning to the banks as private deposits against which the usual reserves will be required (and deposit insurance assessed). Excess reserves then will be drawn down quite rapidly, the rate of their disappearance depending not only upon the size of the Treasury calls but upon such other factors as withdrawals of currency from the banks and purchases or sales of government securities by the Federal Reserve Banks.

Earnings of Large War Material Manufacturers

The belief that the large producers of munitions and war materials are making "exorbitant" or "unconscionable" profits out of the war effort evidently still persists in some quarters, despite the wealth of evidence to the contrary which is now available. To some extent this belief is based upon ignorance of the facts, uncritical acceptance of various misrepresentations, or assumption that a few exceptional instances are typical. In others a desire to discredit the war producers, whether from prejudice or other motives, appears to be a factor. Within the past month Mr. John L. Lewis, in the course of an argument to justify wage increases for the mine workers, made a public statement that 12½ per cent of the Government's war expenditures represented profit to industry or finance.

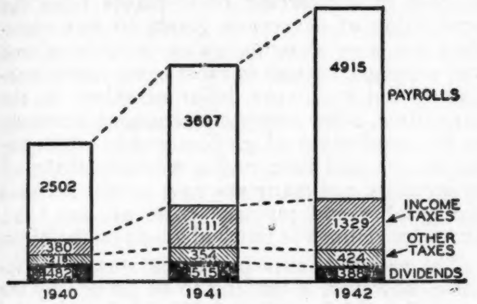
If the view of Mr. Lewis and others of similar belief should be widely held, an unjustified stigma would attach to the war producers. The disbursements of the Treasury to the war industries appear in their income statements as sales. Mr. Lewis's allegation therefore is that these industries have a profit margin of 12½ per cent on sales. He stated that this was an estimate. The facts now available show, however, that the actual average profit on sales, after taxes, reported by large companies for 1942 was but little more than 4 per cent.

The Evidence as to War Profits

Evidence as to the truth about war profits is now readily obtainable. Most of the larger companies engaged principally in war production have issued their 1942 earnings reports, and these show marked declines in rates of return on both capital and sales as compared with 1940 and 1941. Furthermore, many of

these reports yield information not only as to the return on capital, in the form of earnings and dividends, but also as to the return to labor, in the form of wages. They reveal marked changes, since the beginning of the war effort, in the distribution of gross income as between capital, labor, and government.

Analysis of a group of 40 large and nationally-known manufacturers of war products, whose reports contain these data, shows an enormous expansion between 1940 and 1942 in volume of sales, as well as in payrolls and tax reserves, but a substantial decline in net income and in dividends paid. These changes are illustrated by the accompanying diagram.



Payrolls, Taxes and Dividends of 40 Large Manufacturers of War Materials
(In Millions of Dollars)

These organizations produce steel, machinery, electrical and radio equipment, tanks and other military vehicles, airplanes, ships, tires, guns, shells, explosives, woolen goods and a multitude of other essential parts and materials, and employ an aggregate capital and surplus exceeding $6,600 millions. The composite income and its distribution in the past three years is given in the accompanying table.

The table reflects the tremendous increase brought about the war in sales, payrolls and costs of goods and services purchased from others, including many thousands of subcontractors. The average number of employes during the year, partly estimated, increased from 1,391,000 in 1940 to 2,009,000 in 1942, while the average annual compensation per employe rose from $1,800 to $2.450.

Despite the enormously increased volume of business, however, rising expenditures of all kinds, including taxes, caused net income after taxes to fall 23 per cent below that of 1941 and 17 per cent below 1940. It is interesting that although income and excess profits tax rates were raised further in 1942, the taxes payable were only moderately higher, due to advancing costs which checked the rise in taxable income.

The decline of 23 per cent in net income of this group of large contractors in 1941-42 was sharper than the average for leading companies

40 Leading Manufacturers of War Materials
(In Millions of Dollars)

Income Account	Year 1940	Year 1941	Year 1942	Per Cent Change 1941-42	Per Cent Change 1940-42
Net sales & other rev.	$7,659	$11,230	$13,895	+24	+81
Cost of goods and services purchased from others, depreciation, interest and other expenses and reserves	3,854	5,393	6,640	+23	+72
Balance of gross income	3,805	5,837	7,255	+24	+91
Distributed as follows:					
Wages and salaries	2,502	3,607	4,915	+36	+96
State, local, social security, foreign and misc. federal taxes	218	354	424	+20	+94
Income and excess profits taxes	380	1,111	1,329	+20	+250
Total taxes	598	1,465	1,753	+20	+193
Dividends paid	482	515	388	—25	—20
Income retained	223	250	199	—20	—11
Total net income	$ 705	$ 765	$ 587	—23	—17
Percentage distribution of above "Balance of gross income"					
Wages and salaries	65.8	61.8	67.7		
Taxes	15.7	25.1	24.2		
Net income	18.5	13.1	8.1		
Total	100.0	100.0	100.0		

These companies, a large number of whose plants have been awarded the Army-Navy "E" for excellence in production, include the following:

Allegheny Ludlum Steel Corp.	Johns-Manville Corp.
Allied Chemical & Dye Corp.	Jones & Laughlin Steel Corp.
Allis-Chalmers Mfg. Co.	Lukens Steel Co.
American Locomotive Co.	National Gypsum Co.
Am. Radiator & Std. San. Co.	National Steel Corp.
American Woolen Co.	Pittsburgh Plate Glass Co.
Armstrong Cork Co.	Pittsburgh Steel Co.
Baldwin Locomotive Works	Pullman, Inc.
Bendix Aviation Corp.	Radio Corporation of America
Bethlehem Steel Corp.	Republic Steel Corp.
Blaw-Knox Co.	Sloss-Sheffield Steel & Iron Co.
Botany Worsted Mills	Thompson Products, Inc.
Bridgeport Brass Co.	United States Rubber Co.
Caterpillar Tractor Co.	United States Steel Corp.
Crucible Steel Co.	Western Electric Co.
Eastman Kodak Co.	Westinghouse Air Brake Co.
General Electric Co.	Westinghouse Elec. & Mfg. Co.
General Motors Corp.	Wheeling Steel Corp.
Goodyear Tire & Rubber Co.	Willys-Overland Motors, Inc.
International Harvester Co.	Youngstown Sheet & Tube Co.

representing the manufacturing industry as a whole, which, according to our tabulation given last month of 1,336 corporations, showed a decline of but 14 per cent.

Moreover, the accompanying summary represents, if anything, an over-statement of actual earnings last year, for in many cases the reports call attention to the fact that the accounts are subject to the renegotiation of contracts which may lower the 1942 sales, taxes and net income by amounts as yet indeterminable. In numerous cases, however, the 1942 results already give effect to large savings in costs which have been voluntarily refunded or credited to the Government, and have been deducted from sales.

Dividends, preferred and common, paid to shareholders last year were 25 per cent below 1941, and 20 per cent below 1940. Net income retained in the business, for financing the expanded volume of sales, inventories and receiv-

ables, likewise was below that of both years preceding.

The portion of sales carried through to net income after taxes declined from 9.2 per cent in the prewar year 1940 to 4.2 per cent in the full war year 1942, while the portion actually distributed in dividends fell from 6.3 per cent to 2.8 per cent. Individual income taxes and surtaxes upon such dividends cut still further the net return to shareholders.

Taxes were about 1¼ times as large as dividends in 1940, but 4½ times as large in 1942.

Payrolls in 1940 were five times as large as such dividends or "wages for tools" in the form of plant, equipment and working capital provided by the 1,800,000 individual and institutional shareholders, but in 1941 payrolls were almost seven times, and in 1942 were over twelve times as large as dividends.

The foregoing figures speak for themselves. There have been, of course, exceptions to the downward trend of earnings in the case of individual companies which, through cutting production costs by improved methods and mass output, have increased their earnings and paid out higher dividends, just as every year numerous companies run counter to the general trend. These exceptional cases are now being taken care of through the excess profits taxes, and through the renegotiation of contracts with the Price Adjustment Boards of the Army, Navy, Maritime Commission, and Treasury Department.

First Quarter Earnings

Reports for the first quarter that have been issued by 260 industrial companies show a combined net income after taxes of approximately $254 millions, which is 7 per cent higher than the $237 millions reported in the first quarter of 1942, but 24 per cent lower than the $334 millions in the first quarter of 1941. Current earnings are subject in many cases to the renegotiation of government contracts. This group is representative for the most part of the larger organizations in the various manufacturing industries and on January 1, 1943 had capital and surplus aggregating $12,052 millions.

The number of companies showing increases over last year exceeded the number showing decreases by 152 to 108. Numerous concerns which a year ago were at a low point in the process of converting their plants from the production of peacetime goods to war materials are now showing gains in both volume and earnings, though in most cases lower margins of net profit per dollar of sales. At the same time, other companies engaged primarily in the production of civilian goods which are being curtailed have had a marked falling off in earnings, and many are now caught between rising labor and material costs on one hand, and price ceilings of finished goods on the other.

The extent of current fluctuations in net income, however, is tending to be limited by the prevailing high rates of federal income and excess profits taxes. Taxes offset up to 90 per cent any increase or decrease in earnings. Thus Government is the chief beneficiary of expanding and profitable operations, and suffers the principal loss in the case of reduced earnings resulting from curtailed volume, rising costs, or both.

Tax details given by 145 of the companies in our tabulation show that in the first quar-

NET INCOME OF LEADING CORPORATIONS FOR THE FIRST QUARTER

Net Income is Shown After Depreciation, Interest, Taxes, and Other Charges and Reserves, but Before Dividends—Net Worth Includes Book Value of Outstanding Preferred and Common Stock and Surplus Account at Beginning of Each Year.

(In Thousands of Dollars)

No.	Industrial Groups	Net Income First Quarter 1942	Net Income First Quarter 1943	Per Cent Change	Net Worth January 1 1942	Net Worth January 1 1943	Annual Rate of Return % 1942	Annual Rate of Return % 1943
22	Food and beverage	$ 18,711	$23,838	+ 27.4	$727,263	$738,619	10.3	12.9
11	Textiles and apparel	1,948	2,584	+ 32.6	116,264	123,320	6.7	8.4
10	Paper products	3,661	2,603	— 28.9	167,121	171,355	8.8	6.1
24	Chemicals, drugs, etc.	41,492	42,190	+ 1.7	1,434,600	1,494,585	11.6	11.3
8	Petroleum products	23,637	26,020	+ 10.1	1,792,618	1,822,660	5.3	5.7
11	Stone, clay and glass	3,653	3,845	+ 5.3	250,606	256,945	5.8	6.0
24	Iron and steel	47,070	41.778	— 11.2	3,021,736	3,081,499	6.2	5.4
6	Electrical equipment	16,120	15,786	— 2.1	596,772	612,839	10.8	10.3
15	Machinery	5,652	5,960	+ 5.4	199,258	212,240	11.4	11.2
23	Autos and equipment	29,882	42,238	+ 41.3	1,361,913	1,454,736	8.8	11.6
40	Other metal products	25,126	23,598	— 6.1	980,115	1,009,456	10.2	9.4
17	Misc. manufacturing	3,494	3,988	+ 14.1	201,078	206,373	7.0	7.7
211	Total manufacturing	220,446	234,428	+ 6.3	10,849,344	11,184,627	8.1	8.4
26	Mining and quarrying	11,437*	12,912*	+ 12.9	482,134	488,318	9.5	10.6
13	Trade (whol. and retail)	3,527	4,119	+ 16.8	219,508	225,279	6.4	7.3
10	Service and construction	1,985	2,717	+ 36.9	148,279	153,522	5.4	7.1
260	Total	$237,395	$254,176	+ 7.1	$11,699,265	$12,051,746	8.1	8.4

*Before certain charges.

ter of this year the reserves for income and excess profits taxes, after allowance for the post-war refund, amounted to approximately $462 millions, which was 18 per cent higher than the $390 millions reserved by the same companies in the first quarter of 1942. Such taxes took 70 per cent of the net income before taxes this year, against 67 per cent last year. Of the $81 millions *increase* in net income before taxes shown by the companies giving tax details, taxes took $72 millions or almost nine-tenths.

Of the 211 manufacturing companies in the summary, whose combined net income increased 6 per cent over last year, sales of 63 companies reporting such figures increased from $2,339 millions to $3,122 millions, or 33 per cent. This indicates the continued narrowing in margins of net profit on sales. The further expansion this year in sales of the manufacturing industries, as a group, contrasts with the trends in the retail fields, where first quarter mail order sales were down 8 per cent from last year, and sales of all other chain store organizations, including food, were up only 9 per cent.

A summary of leading company reports, as we have pointed out heretofore, is useful as indicating earnings trends but does not provide an accurate measure of average earnings for industry as a whole. Moreover, besides being subject in many cases to the renegotiation of contracts, the current figures may have to be adjusted in accordance with any changes in tax rates and provisions that may be enacted later in the year, but made retroactive to January 1st.

Utility Earnings Mixed

Most of the large public utility systems established new high records this year in operating revenues, but the trends in net income were mixed, due to the advance in operating expenses and taxes.

Twenty-five of the large utility systems supplying electric power, gas and other services showed the following changes:

(000s omitted)	First Quarter 1942	First Quarter 1943	Per Cent Change
Total operating revenues..	$280,759	$294,503	+4.9
Net income after taxes......	38,972	38,352	—1.6

The increase in demand for electricity has come primarily from industry; residential demand still is running ahead of a year ago but not at the accustomed rate. Thirteen of these systems showed increases in first quarter net income, while twelve showed decreases. The utilities are being hard hit by rising taxes, which last year amounted to almost twice their total payrolls.

Railroads Making New Records

Operating revenues of the class 1 railroads in the first quarter were approximately 40 per cent above last year, and by far the highest for any first quarter in history. Net railway operating income in the first two months increased 61 per cent over last year, despite a 132 per cent increase in taxes, and the net income after fixed charges more than doubled. Most of the increase in net income this year is being used, as was done last year, for the retirement of funded and short-term debt, and for building up holdings of cash and tax notes.

Comparative figures over the balance of the year, however, will be against the rapidly rising level of a year ago, and will be affected also by the recent order of the Interstate Commerce Commission that the emergency freight and passenger rate increases, granted about a year ago after wage increases had been granted, be rescinded, except in the case of interstate passenger fares, effective May 15.

Proposals for Post-War Currency Stabilization

Of the many difficult problems that will have to be faced after the war, one of the most urgent will be that of reestablishing the currencies of the different countries on a basis that will give confidence and encourage revival of trade. Next to the feeding of starving populations and the maintenance of order in areas where local government may be temporarily broken down, nothing is more important than getting people back to work producing the things they need, rebuilding depleted supplies, and restoring their industries to effective peacetime operation. But if people are to do business with one another, and especially if they are to have the basis for the advance planning essential to full recovery of trade and employment, they must have faith in the money they use. It is because of the widespread recognition of this fact, and the fear of international monetary chaos after the war, that the tentative proposals for stabilization recently made public by the United States and British Treasuries have excited such great interest.

In advancing their respective plans, both the United States and British Treasuries have stressed their provisional nature. They are the work of technical experts — Dr. Harry D. White, director of the Division of Monetary Research of the Treasury, in the case of the American plan, and Lord Keynes, widely known British economist, advisor to the Treasury and director of the Bank of England, in the case of the British plan—and are put forward as exploratory approaches to the problem of monetary stability for study and discussion. Neither plan has been officially adopted by the American or British Governments, and although both have been available to other interested governments for analysis and criticism the discussions have been between the

technical experts, and the Governments themselves have remained uncommitted.

This is all to the good. Certainly we ought to be thinking now about the post-war currency situation, and making plans for joint action with other countries in coping with the problem that will confront us. Both the United States and British Treasuries have rendered a service in promoting these studies and bringing forward concrete proposals which get the subject out of the realm of generalities and give us something definite to work on. At the same time both Governments have been wise in refraining from rigid and premature adherence to any particular formula, and in inviting the fullest possible public consideration and debate. The questions involved are so complex and the ramifications so far-reaching — extending into the area of national internal economic policies — that they will need most careful thinking through.

American and British Plans Compared

Briefly stated, what both plans propose is an international agency through which member countries would cooperate in determining and controlling exchange rates, and which would provide facilities for temporary support of currencies experiencing pressure. Both plans recognize that currency stability is fundamentally a matter of maintaining equilibrium in payments between countries, and provide for procedures aimed at restoring such equilibrium in cases where departure is leading to currency weakness.

Both plans are intended primarily for bridging over temporary or intermediate inequalities in the exchanges that might otherwise lead to disturbing rate fluctuations, and give time for remedial measures. The stabilization agencies to be set up would not be expected to supply long-term reconstruction or development capital, which both plans agree would have to be made available through other channels.

Though aimed at accomplishing essentially the same results, the mechanisms envisioned by the two plans would differ substantially in form and method of operation. The American plan contemplates an actual fund of gold, foreign exchange, and securities under control of an agency which would have broad powers for dealing in foreign exchange and securities, for issuing its own securities, and borrowing from central banks. The British plan on the other hand, proposes an international clearing house, without capital assets, through which accounts could be settled and debtor countries be permitted temporary overdrafts.

Both plans would create a new international monetary unit — "unitas" under the American plan, and "bancor" under the British plan — which would not circulate generally, but be used merely as a medium of account on the books of the Stabilization Fund or Clearing Union. Dollars, sterling, or any other leading currency would, of course, serve as well except for the question of national prestige. The gold value of unitas would be fixed permanently, while that of bancor could be changed by the governing board.

Under both plans, management would be vested in a governing board, which would have power to fix exchange rates*, and member countries would pledge themselves not to alter their exchange rates except as approved by this board. Distribution of voting power and right to credit facilities would be in accordance with the share, or quota, of each country in the Fund or Union. The American plan would base quotas upon "various factors, including holdings of gold and foreign exchange, magnitude of fluctuations in balances of international payments, and national income", with the limitation that no one country could cast more than 25 per cent of the total votes. Just how these various factors would be evaluated is not stated in the advance texts. Quotas under the British plan would apparently be based largely on trade volume, although it is suggested that other factors might be taken into account.

At the heart of the problem are the provisions for dealing with situations where a disequilibrium has arisen in the balance of payments and where, as a consequence, the holdings of currency or the debit balances of a country are accumulating in the Fund or Union. In such cases, both plans provide, as set forth on the next page, for additional credit facilities under certain prescribed limitations and conditioned upon the debtor country taking steps recommended by the governing board to redress its balance of payments. Such steps, it is stated specifically in the British plan, might include such measures as a devaluation of currency, control over capital movements, or even such internal measures as the Board deems appropriate. In other words, it is intended to give aid to countries experiencing exchange difficulties, but at the same time to make the continuance of such assistance dependent upon these countries putting their houses in order.

A significant feature of both plans is the obligation imposed on creditor as well as debtor countries to help maintain exchange equilibrium. "The system," says the British text, "looks on excessive credit balances with as critical an eye as on excessive debit balances, each being, indeed, the inevitable concomitant of the other." Member countries are expected to discourage excessive accumulation of foreign exchange by their nationals, and provision

*Under British plan member states would agree between themselves the initial value of their own currencies in terms of bancor.

CONDENSED SUMMARY OF PRINCIPAL POWERS OF CURRENCY STABILIZATION AGENCY UNDER AMERICAN AND BRITISH TENTATIVE PLANS

AMERICAN PLAN

General Currency Powers

Fund to have power to fix exchange rates; to buy, sell and hold gold, currencies, bills of exchange and government securities of member countries; to accept deposits and to earmark gold; to issue its own obligations and to discount or offer them for sale in member countries; to borrow from central banks; and to act as clearing house for settling international movements of balances, bills of exchange and gold.

Powers limited to dealing with or through (a) the treasuries, stabilization funds, or fiscal agents of member governments, (b) the central banks, only with consent of the member of the Board representing the country in question, and (c) any international banks owned predominantly by member governments. Fund may, however, with approval of Board member representing the government of the country concerned, sell securities directly to public or to institutions of member countries.

Problem of Debit Balances

Fund holdings of any currency must not exceed during first year of operation of the Fund the quota for that country; must not exceed during the first two years 150% of such quota; and thereafter shall not exceed 200%, except on a four-fifths vote where at least one of two conditions are met:

(a) the country agrees to adopt and carry out measures recommended by the Fund to correct the disequilibrium in the balance of payments, or

(b) it appears that the accumulation of the country's currency in the Fund will be temporary.

When Fund holdings of any currency exceed quota, the country must deposit a special reserve as prescribed by the Board of Directors.

When a country is exhausting its quota more rapidly than seems warranted, the Board may place such conditions on additional sales of foreign exchange to that country as deemed to be in the general interest.

A charge at the rate of 1% per year, payable in gold, to be levied against any member country on the amount of its currency held by the Fund in excess of quota.

Problem of Credit Balances

When Fund holdings of any currency drop below 15% of quota, and after the Fund has used for additional purchases of that currency,

(a) gold in an amount equal to the country's contribution of gold to the Fund, and

(b) the country's obligations originally contributed,

the Fund will render to the country a report embodying an analysis of the causes of the depletion of its holdings of that currency, a forecast of the prospective balance of payments, and recommendations for increasing the Fund's holdings of that currency. This report should be sent to all member countries and, if deemed desirable, made public.

Moreover, in the event of threatened shortage of any currency, the Board shall inform all member countries of the probable supply of this currency and of a proposed method for its equitable distribution.

To promote most effective use of available and accumulating exchange resources, each member agrees to offer to sell to the Fund, for its local currency or for foreign currencies which it needs, all exchange and gold it acquires in excess of holdings immediately after joining the Fund. The Fund shall inform any member when, in its opinion, any further growth of privately-held foreign balances appears unwarranted.

BRITISH PLAN

General Currency Powers

Power to fix bancor in terms of gold. Power, after initial stabilization, to fix exchange rates of individual currencies in terms of bancor.

Member states may obtain credit balances in bancor by selling gold to Clearing Union. No member may demand gold from Union, but Governing Board may distribute its holdings between members having excess credit balances.

Union to be set up not for handling daily business between individual traders or banks, but for settlement of balances between central banks.

Problem of Debit Balances

A member state may not increase its debit balance by more than one-quarter of its quota within a year without permission. If its debit balance has exceeded a quarter of its quota on the average of at least two years, it may reduce the value of its currency in terms of bancor by not more than 5% without consent of Governing Board; but may not repeat this procedure without permission.

Governing Board may require member state having debit balance of half its quota to deposit suitable collateral. Such collateral shall, at the discretion of Governing Board, take the form of gold, foreign or domestic currency or government bonds.

As a condition of allowing a member state to increase its debit balance to more than half its quota, the Governing Board may require all or any of the following measures:

(a) A stated reduction in the value of the member's currency,

(b) the control of outward capital transactions, and

(c) surrender of a suitable proportion of any separate gold or other liquid reserve in reduction of its debit balance.

Governing Board may recommend to the member state internal measures which may appear appropriate to restore its international balance.

If a debit balance has exceeded three-quarters of quota on the average of at least a year and is excessive in the opinion of the Board, or is increasing at an excessive rate, it may be asked to take measures to improve its position, and, in event of its failing to do so within two years, the Board may declare it in default and no longer entitled to draw against its account except with permission.

A member state to pay 1% annually on the amount of its average balance in bancor, whether a credit or debit, in excess of one-quarter of its quota; and a further charge of 1% on its average balance, whether credit or debit, in excess of one-half of its quota. Thus, only countries which keep in international balance will escape contribution.

Problem of Credit Balances

A member state whose credit balance has exceeded half of its quota on the average of at least a year shall discuss with the Board (but retain the ultimate decision) measures for restoring equilibrium, including:

(a) expansion of domestic credit and domestic demand,

(b) appreciation of its local currency in terms of bancor, or, alternatively, the encouragement of an increase in money rates of earnings,

(c) reduction of tariffs and other discouragements against imports,

(d) international development loans.

Board to ask and receive from each member any relevant statistical and other information including full disclosures of gold, external credit and debit balances and other external assets and liabilities, both public and private.

is made for furnishing information of such accumulations. Moreover, as indicated in the accompanying summary, the governing board, under both plans, may make recommendations to countries accumulating excess credit balances, designed to correct the situation. The British text is more specific as to the nature of such recommendations, mentioning as possibilities the adoption of expansive domestic credit policies, appreciation of the currency, reduction of tariffs and other discouragements to imports, or international loans. Ultimate decisions, however, are evidently reserved to the individual countries, and in the British text it is definitely so stated.

Both plans recognize the special problem created by the accumulation in some countries, notably Great Britain, of large blocked foreign balances as a consequence of the war. The American plan proposes the purchase of such balances by the Stabilization Fund and their liquidation over a period of 23 years in accordance with a prepared program. While the British plan advances no specific method for handling these balances, it suggests that there should be special provision during a transitional period for converting them into bancor without strain on the debtor country.

Will It Work?

The foregoing review has attempted to sketch, as fully as possible in the limited space here available, the main features of the two plans. Both schemes are ingenious, and reflect imagination as well as painstaking labor. But will the different countries accept any over-all plan of this kind, and if so, would it work? These are the questions that people are asking.

It would be undesirable to attempt too summary a judgment of the two plans, both of which have been stated to be tentative and hence not intended to be accepted or rejected in entirety. They raise political as well as economic questions. Both plans will take a lot of pondering, and all countries will want to weigh carefully the various provisions in the light of their own circumstances, and endeavor to appraise all the implications. On many points much more information is needed. In particular, countries will want to know a great deal more about their shares in any international credit agency of such imposing powers, their financial commitments, and the amount of their general "say-so"; also and especially, the extent to which their freedom to manage their own affairs would be affected.

Certain principles embodied in the plans can, however, receive recognition and approval.

First, there is the principle that stable currencies are needed for prosperous trade. The world had an experience with unstable currencies during the 'thirties, and learned that the so-called "benefits" are illusory. Both plans recognize currency stability as one of the goals of post-war policy. Secretary Morgenthau stated the principle clearly when he said in submitting the American plan to Congress, "we feel that international currency stability is essential to reconstruction in the post-war period and to resumption of private trade and finance."

Second, there is the principle that some form of international cooperation and consultation is necessary in reestablishing currencies and maintaining stability. In the closely knit fabric of international commerce and prices, currency relationships are too vital a matter to be left entirely to isolated individual decision. The Tri-partite Accord between the United States, Great Britain, and France (substantially joined by Switzerland and Holland) in 1936 was an example of international monetary cooperation; and almost everyone agrees that in the difficult post-war task of fixing new currency parities, of making adjustments where necessary, and of helping countries get on their feet, some form of common understanding and joint effort is needed.

Third, there is the principle that a monetary system, to command the confidence of the people, must utilize gold. Both plans recognize this principle. Both unitas and bancor would be valued in terms of gold, and the Stabilization Fund and Clearing Union would both be purchasers of gold, assuring a ready market for producers and holders of gold.

As between the two plans, however, the American assigns much the more important role to gold. While the gold value of unitas would be fixed permanently, that of bancor could be changed. Moreover, the American Stabilization Fund would from the beginning hold gold as a stated part of its assets through which international settlements would be effected; and as part of its routine operations would buy, sell, hold and earmark gold. The British Clearing Union, on the other hand, would not necessarily be a fund at all but primarily a bookkeeping arrangement.

Essentials of Currency Stability

In dealing with proposals for achieving currency stability, it is well to consider some of the governing principles. What are the conditions that make for exchange stability?

Boiled down to a word, the answer is — as indicated earlier — equilibrium. That is, the flow of payments of all kinds crossing national boundaries must balance. These payments arise out of a multitude of different kinds of transactions — imports and exports of merchandise, interest and dividend payments, tourist expenditures, commissions, premiums, payments for special services such as shipping, etc., as well as loans, investments, and various other types of capital transfers. If out of this maze of criss-crossing transactions, payments flowing from a country exceed those flowing to it, the

supply of exchange of that country will be in excess and the rate will tend to weaken. While gold shipments or loans may afford a temporary support, unless fundamental changes occur to equate the balance of payments the end sooner or later must be collapse.

In other words, international payments cannot flow continuously on a one-way street. Nor is there any magic in the term "unitas" or "bancor" or any other name to make this possible. The fact that the British, Australian, and New Zealand currencies are all quoted in pounds, and the United States and Canadian currencies in dollars, has not prevented wide fluctuations in the rates between. These fluctuations would not have been any greater or less no matter what the names invented.

The reasons why payments can become unbalanced between countries are many. Some arise from short-run causes — seasonal fluctuations, failure of an important crop, or other maladjustments of a short-term nature. Such periods can usually be tided over by gold shipments or by temporary credits.

But there are other and more deep-seated causes of lack of balance in international payments. They include political instability and fear of war, as in Europe before 1939; excessive tariff and other trade restrictions; tax and other measures discriminatory against capital; doubts regarding the value of the currency; and unsound credit and fiscal policies that lead to advances in prices and costs and get the economy up on stilts so that export trade is shut off. One of the most frequent and certain causes of currency instability is a persistently unbalanced budget, which undermines a nation's vitality and destroys confidence.

Only as these causes are removed can disequilibrium itself be corrected, and exchange rates held stable. Apart from war or peace, this comes down very largely to a question of domestic policies in which individual countries are likely to be extremely jealous of their prerogatives. Moreover, it is a problem within each country of dealing with highly controversial issues, of resisting pressure groups, and of promoting a public opinion that will support sound policies.

The essential factors are thus twofold in character. One factor consists of the general political and economic background in which stablization is attempted—the condition of international security, the soundness of national economies, the policies as to budgets and trade, the flow of goods and capital, and the general state of enterprise and confidence.

The second factor is the more specific one of the precise monetary arrangements. It is in this area that the present proposals have their special application. They are no substitute for the first, as both plans themselves recognize. The elements of this second factor are (1) a definite commitment to the principle of stability, (2) international consultation, and recognition that in dealings between countries, as in dealings between individuals, there must be willingness to give and take, and (3) arrangements by which stronger countries may extend credit to other countries to take care of inevitable fluctuations of trade and flow of capital.

Both of the plans that have been proposed are a definite attempt to accomplish these objectives. The problem lies in devising procedures which will command general acceptance, and which will afford the maximum hope of accomplishing results with the minimum of complexity and overhead management. To attempt too much might have the effect of swinging public opinion to the opposite extreme and thus be as fatal as not to attempt enough.

Use of Present Facilities

In the meantime, it may be noted that we have not been standing still. The statement of Secretary Morgenthau last month to the Senate Banking and Currency Committee on extending the powers of the present U. S. Stabilization Fund reveals to what extent we have been working, through the existing instrumentalities, — notably the Stabilization Fund — to give effective aid to certain countries. This statement is impressive, listing in some detail agreements with Russia, China, Cuba, Brazil, Mexico, Ecuador, Iceland, and Liberia, with agreements with Bolivia and Iran now pending. These are in addition to the Tri-partite Accord of 1936. The Secretary said in summary:

> The pattern for international monetary cooperation that we have developed in the operation of our Stabilization Fund holds a real promise of achieving currency stability in the post-war period. We took an important step in the direction of international cooperation for currency stability through the Tripartite Accord in 1936. Unfortunately, the functioning of the Tri-partite Accord was interrupted by the war. Nevertheless, we have continued to embody the principles of that Accord in our stabilization agreements with our neighbors in Latin America and with other friendly countries. These agreements provide for maintenance of exchange stability and for periodic consultation on financial and economic conditions that may affect the stability of exchange rates.
>
> Under provisions safeguarding our interest, we have made available the resources of the Stabilization Fund for the purpose of maintaining stability of exchange rates. In the five years before the war and in the nearly four years since the outbreak of war, the operations of the Stabilization Fund have contributed to maintaining relatively stable exchange rates, despite the unprecedented conditions of political and economic disorder.

In addition to these activities of the Treasury, the annual reports of the Federal Reserve Board have shown that, besides supplying the operating mechanism for the Stabilization Fund, the Reserve Banks in the past few years have extended credits for short-term needs and based on gold to a number of foreign central banks.

THE Second War Loan has gone over the top with subscriptions of more than 16 billion dollars.

The banks of the country are proud that they played a large part in organizing this campaign and carrying it through to a successful conclusion.

The National City Bank of New York, with its 66 branches in Greater New York, threw the full strength of its organization into the campaign.

These same facilities are now available as "service stations" for the people in their day-to-day purchases of war savings bonds. For the purchase of government bonds must go forward steadily—just as the war goes forward—without interruption.

The National City Bank has aided in financing our Nation in six wars beginning with the War of 1812. Today in a global war the country's resources are being put to a new test. The banking system is being asked to meet new and greater demands. Our world-wide organization has pledged all its facilities to provide the banking services essential to victory.

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